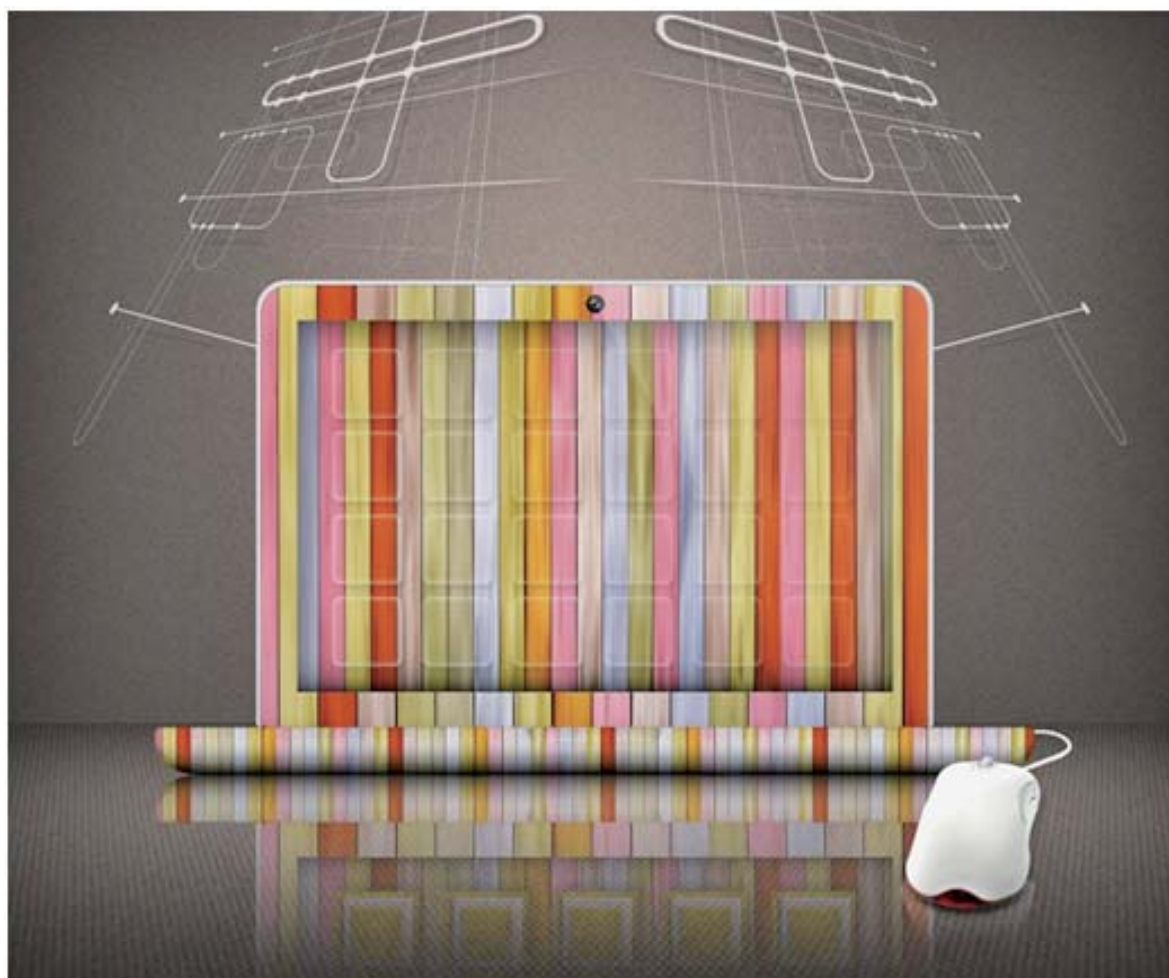


Report on the Diversification
of China's Education Industry
2014 .



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Foreword

Since the beginning of 2014, two hot issues have emerged in China's private education sector. First, in March this year, Premier Li Keqiang pointed out that "vocational education reforms should keep current with social progress", emphasizing that "efforts should be made to develop vocational education and professionals that are suited to market needs, to create a merit-based but not diploma-oriented social atmosphere." This statement opens up a new pathway for vocational education, serving as a beacon for the development of private and vocational schools in China. Second, an investment spree in the on-line education sector beginning the second half of 2013, has continued to make headlines in mainstream media. Internet behemoths are making inroads into this new business area, leading to turbocharged growth of the online education market. But a look at the private education market clearly shows that online education represents only a small proportion. In fact, the market is now growing at a slower pace, in its transition from "enclosure movement" to "intensive cultivation". In this stage, How China's private education groups diversify becomes especially vital.

Given these developments and hot issues in the education sector, Deloitte takes "diversification of education groups and development of online education" as the theme of this annual report. The chapter on diversification provides an analysis of how international schools and training institutions are diversifying differently. As they are still in a stage of extensive expansion, international schools are focusing on replicating their successful models in regional branches. For training institutions, diversification is a key means of offsetting the rising costs of teacher salaries, marketing and rent. Our analysis leads us to conclude that China's education groups have largely diversified through M&A transactions, 87 percent of which are made by listed companies. Deloitte predicts that M&A activity by education groups will continue to grow, and private education groups will heavily rely on M&A for further development.

Chapter 3 provides an overview of the current status of China's online education and its challenges, as well as the way forward and opportunities. Undoubtedly, we must keep our thinking in sync with the world's evolving trends, if not a step ahead of them, so that we may gain first-mover advantages in a changing marketplace. We must think hard about the myriad possibilities that the Internet has brought to education, and embrace the Internet-age thinking to guide the education business. In the final chapter, we raise three questions for further discussion: (1) Can technicians be put on an equal footing with academicians? (2) Can the era of online learning extend the value of star teachers? (3) Can online education be free?

This year, Deloitte is publishing its fifth annual report on the education industry. We appreciate the consistent support provided by experts in the education industry, and we look forward to the opportunities to explore emerging issues, big or small, in the industry, and to exchange views on them. Suggestions on further improvement of the report are always welcome.

Charlotte Lu
Education Industry Co-leader
Deloitte China

Chapter 1. Introduction to the Private Education Industry in China

1.1 Overview of China’s Private Education Market

In the past year, as the country grows richer, people’s demands for private education in China have become more diversified, and investments in this market by domestic and international investors have reached a new level. Overall, the market is growing at a slower pace, which suggests that private education in China has transitioned from a rapid growth phase to a stage of consolidated development.

- Publicly-listed education companies achieved an increase of 22 percent in revenues in 2013

In 2013, publicly-listed education companies in China achieved an increase of some 22 percent in business revenues, compared with 32 percent in 2012, and a rise of 15 percent in net profit. It is expected that their performance will keep growing by some 20 percent in 2014.

Table1 : Revenues of Publicly-Listed Chinese Education Companies (US\$m)

Education companies	2013 Fiscal Year Revenue	2012 Fiscal Year Revenue	Revenue growth over prior FY	2013 Fiscal Year net profit	Financial reporting cut-off date (i.e, most recent)
New Oriental	1,055	861	23%	187	30/11/2013
Xueda Education	347	293	18%	16	31/12/2013
TAL Education	287	218	31%	51	30/11/2013
ATA	62	60	4%	6	31/12/2013
China Distance Education	77	55	40%	16	31/12/2013
Hongcheng Education	87	78	11%	8	31/12/2013
NED Noah	38	30	27%	4	31/12/2013
Qtone Education	28	26	8%	8	31/12/2013
Total	1,980	1,621	22%	294	

Source: published quarterly and annual reports, Deloitte Research

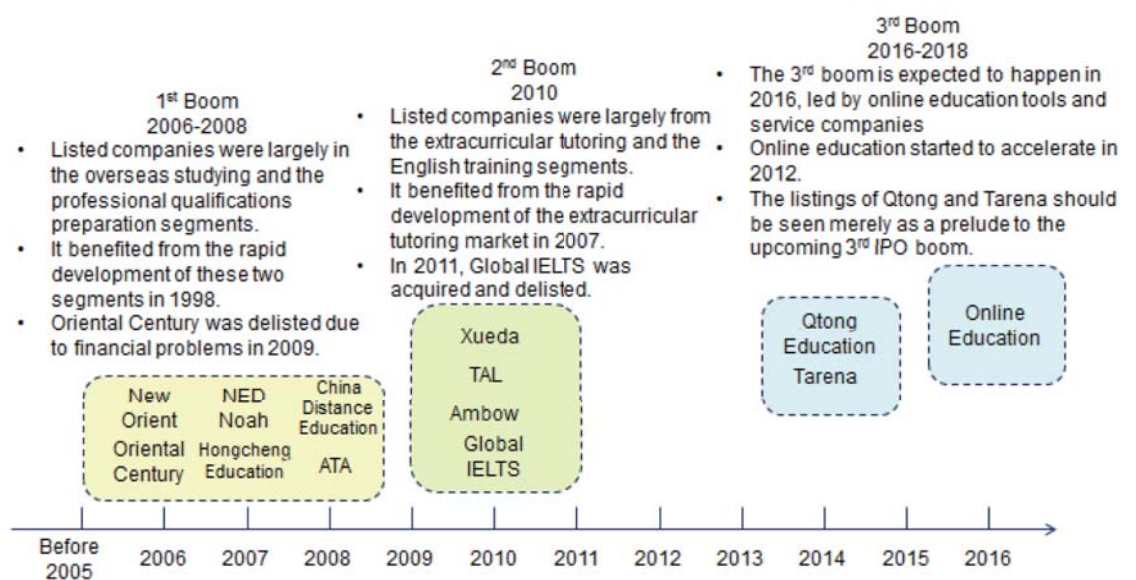


- The 3rd IPO boom is expected to happen between 2016 and 2018

A review of Chinese education companies' IPO history reveals that the first listing boom happened between 2006 and 2008. During this period, a total of six companies largely from the overseas college entrance examination prep and the professional qualifications preparation segments got listed. The second boom appeared in 2010, when four companies from the extracurricular tutoring and the English training segments went public. We expect that the third boom is going to happen in 2016, led by online education companies. 2014 has seen Guangdong Qtong

Education go public in china, and Tarena International file for a public listing on the Nasdaq. However, such limited number of IPOs can be seen merely as a prelude to the upcoming 3rd listing boom. From an investment perspective, investors have fully put in place basic service infrastructure and major innovation projects in the online education sphere, an indication that the online education environment is maturing. The new wave of large-scale investment made in the second half of 2013 is expected to see returns in three to four years' time. Subject to fewer policy restrictions, online education tools and service companies' going public early will herald a third wave of IPOs by education companies.

Figure1: Chinese education companies' IPO history



Source: Deloitte Research

- The online education investment market is sizzling

The private education industry has long been a focus of capital markets. Since the beginning of 2014, the industry has also showed enormous capital accumulation potential. Unlike offline education, whose profit margin is inversely proportional to business scale, online education, in the absence of geographic restrictions and capable of reaching out to a wider audience, is attracting greater attention. Apart from start-ups, an increasing number of large established companies are entering the ring. Many U.S.-listed Chinese education companies have entered the fray, such as New Oriental, Xueda Education, TAL Education, ChinaEdu Corp., China Distance Education, as well as Internet giants, like Alibaba, Tencent, Sina and Netease.

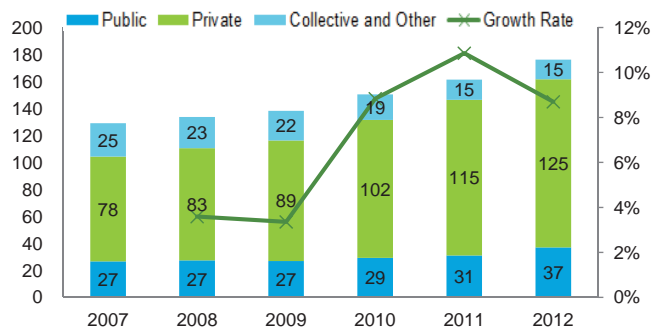
It is obvious from the large number of investment deals that have happened over the last two years (see Chapter 3) that investors all regard online education as a blue ocean, a previously unknown market space. The advantages of online education lie in the absence of geographic restrictions, high degree of standardization and content reuse, and personalized learning. The prevalence of mobile devices has also increased users' stickiness to online education contents. However, companies are struggling to make a profit, as Chinese users are not used to the idea of paying for virtual contents, and find it hard to evaluate their achievements of online study. With more capital flowing into the private education industry, the online education market will be more competitive.

1.2 Status of China's Private Education Market segments

- The relaxed one-child policy promises to bring more opportunities to the pre-school education market

By 2012, China's kindergartens had increased to 180,000, a year-on-year growth of 9 percent. Private kindergartens are major participants in the market, accounting for some 70 percent of all. The market has two major characteristics. First, the number of both high-end kindergartens targeting well-off parents and low-end ones for migrant workers' children keeps growing, and as a result, the pre-school market is expanding. Second, middle-class families are putting an increasingly higher demand on kindergarten brand, teachers' qualifications and teaching programs. China's relaxation of its previous rules on the "one-child policy" in 2014 is expected to bring an additional one million babies every year. And this promises to fuel the expansion of private pre-school education.

Graph1: The Number of Kindergartens in China 2007-2012(in Thousands)



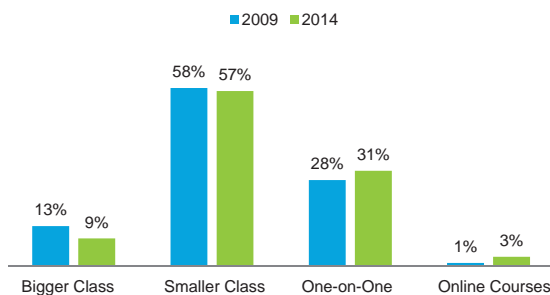
Source: Wind, collated by Deloitte

Note: The relaxed family planning policy allows two children for married couples in which both parents are only children.

- Extracurricular tutoring for primary and secondary school students keeps growing.

China's extracurricular tutoring is a vast market worth RMB 200 billion but remains fragmented. Xueda, TAL, New Oriental, Ambow and Juren have secured lead in extracurricular tutoring, capturing some 3 percent of the market share between them. Small-class teaching and one-on-one tutoring remain the norm, with a focus on Olympiad mathematics and English. The market is entering an age of diversification, featuring personalized services and a greater focus on branding.

Graph2: Extracurricular Tutoring Classes in China



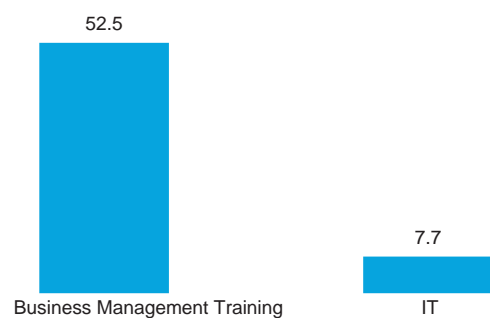
Source: China k12 Tutoring Industry Research and Development Trend Forecast, collated by Deloitte

The new policy dictates that primary students should automatically go to neighborhood high schools, and that no extracurricular marks would be counted towards high school or college entrance exam scores. As a result, the extracurricular tutoring market has seen very different levels of impact. It is obvious that the government is working to balance the distribution of educational resources through policy intervention. But students and their parents are unlikely to lower their requirements for quality educational resources, as long as students are still evaluated based on their learning ability, academic performance and comprehensive qualities. And as long as the exam-based selection system is kept intact, the fierce competition to enter top universities will not ease, leaving space for rapid development of the extracurricular tutoring market.

- Vocational education and training will move up the value chain.

China's vocational education market is highly fragmented, and participants' sizes and specialized areas vary greatly. For instance, the publicly-listed Hongcheng and China Distance Education are online education companies specializing in professional qualifications preparation. This market segment is highly standardized and geared towards qualification exam takers, and the teaching effects are readily quantifiable. The IT training market shares similar features. In February 2014, its industry leader Tarena International filed a submission for an IPO to the SEC in the US. Another big yet fragmented segment in the vocational education sector is business management training. According to IDC, China's high-end vocational training market was worth RMB 67.4 billion in 2013, the bulk of which was business management and IT training. This subsector will maintain a compound annual growth rate of 7 percent over the next three years. With the exception of the slow growing financial, accounting and IT training segments, IT, computer graphic and online marketing training will maintain double digit growth in the coming years, thanks to a huge demand for persons skilled in Internet applications.

Graph3: The Size of the High-End Training Market 2013 (in Billions of RMB)



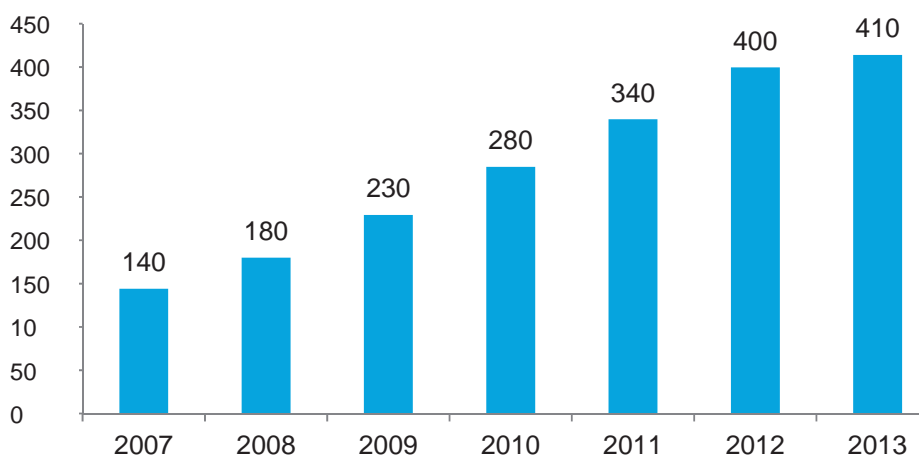
Source: IDC, collated by Deloitte

On a macro level, factors that influence the vocational training market include macro-economic trends, economic transformation and industrial policy, the number of enrollment in and graduates from higher education institutions, inadequacies of the traditional education system, and capital inflows to vocational training. Structurally, China's vocational training market segment is cranked up a notch. Education must meet the needs of social and economic development. China's manufacturing industry is in a stage of transition to greater sophistication, and is therefore in greater need of highly skilled personnel. If the experience of developed economies is of any guide, China's vocational education will expand, fueled by the popularization of higher education, and will keep moving up the industry value chain.

- With study abroad now a fashion, international schools in China are thriving

According to statistics released by the Ministry of Education, enrollment in overseas universities from mainland China in 2013 grew by 14,300, or 3.58 percent over 2012—a significant drop compared to around 20 percent in previous years—to 413,900 students. While the absolute number of students studying abroad only rose slightly, the actual market needs and trend suggest that Chinese students are still strongly attracted to overseas study. And they are going out at a younger age: the number of students pursuing BA degrees overseas has increased significantly, and there will be a gradual rise in the number of high school students studying abroad. All in all, more Chinese students will study abroad. With study abroad now a fashion, international schools (primary and secondary schools) in China are developing rapidly. Roughly, there are 338 international schools in China. See Chapter 2 for the development of international schools.

Graph4: The Number of Chinese Students Studying Abroad (in Thousands)



Source: Ministry of Education, collated by Deloitte

1.3 New Policy on Private Education in China

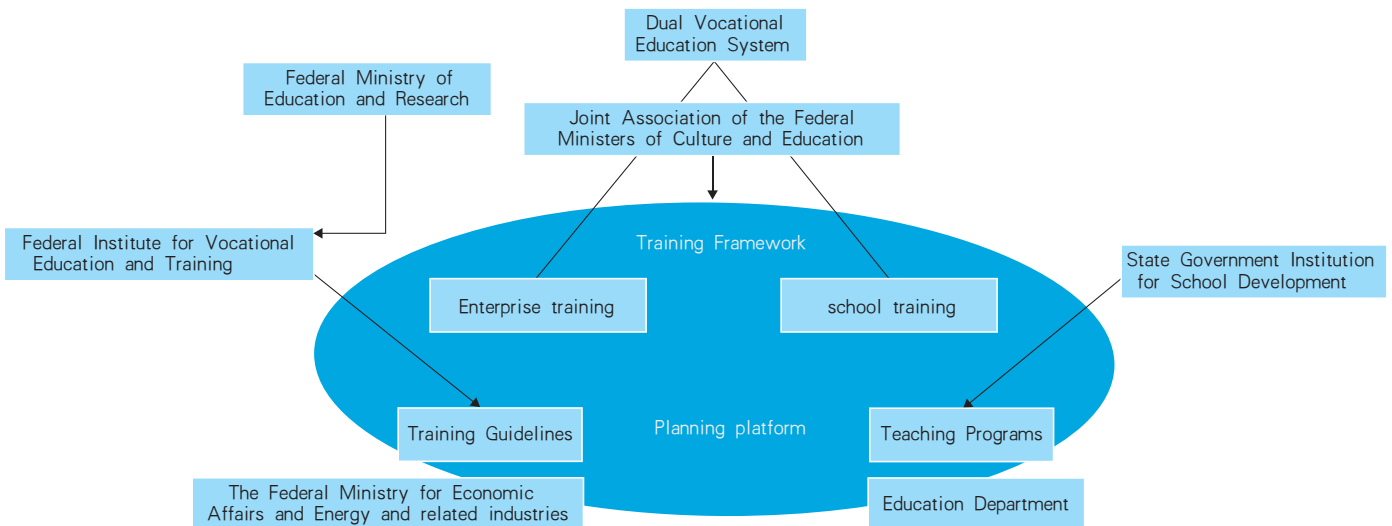
- The State Council aims to accelerate the development of modern vocational education by introducing degree- and certificate-based options

In February 2014, a State Council meeting presided over by Premier Li Keqiang considered and adopted draft Rules on Personnel Management by Public Institutions, in an effort to accelerate modern vocational education. The rules set out three priorities. First, efforts should be made to innovate existing vocational education models, and to guide regular undergraduate institutions to make a transition to colleges specializing in applied technologies. Second, the quality of talent training should be improved by introducing degree- and certificate-based training options. Third, private

investors should be encouraged into the vocational education space, and private vocational schools will be given equal legal status with public ones.

Impact: It is obvious that the government is facilitating seamless link between the supply side of vocational education and the demand side of enterprises, and encouraging private investment. Germany's dual vocational education system shows that corporate training and school training are indispensable links in a complete education system: Students enrolled in vocational schools receive more than twice the amount of training in enterprises than they do in schools. China's private universities and vocational education schools can draw on such a successful model to provide training in conjunction with enterprises.

Figure2: Germany's Vocational Education Management Framework



Source: Publicly-available information.

- The State Council decentralized approval for online training schools that use the Internet to provide distance advanced degree education.

In January 2014, the State Council released the Decision of the State Council on Issues Concerning the Cancellation and Decentralization of Administrative Examination and Approval Items, further cancelling and delegating 64 items and 18 sub-items previously in its mandate to lower levels of administration. Items related to education are as follows:

Table 2

No.	Items	Competent Department	Joint Approval Departments	Legal Basis	Decision
1	Approval of online colleges that provides distance degree education programs using the Internet	Ministry of Education	N/A	«Decision of the State Council on the Enactment of Administrative Licensing for the Confessedly Reserved Items Subject to Administrative Examination and Approval, (Decree No.412 of the State Council)	Cancelled
2	Approval of national key disciplines	Ministry of Education	N/A	Opinions of the Ministry of Education on Strengthening the Construction of National Key Disciplines, (Jiao Yan [2006] No.2)	Cancelled
				Circular on the Ministry of Education's Issuance of the 'Interim Measures on Construction and Management of National Key Disciplines' (Jiao Yan (2006), No.3)	

Source: collated by Deloitte

Impact: The new Decision is expected to fuel competition in the distance degree-based education market. Currently, only 68 universities have received approval to enter the distance degree-oriented education market through their online colleges. As the Decision takes effect, it is expected that more universities will be given the green light, and there may be over 1,000 eligible participants in the market soon. There will be a client base of over three million students pursuing degrees awarded by them. The market is expected to grow to RMB 10 billion. However, education itself should not be altogether viewed through the lens of market value, and a flourishing market does not necessarily guarantee quality education. Risks will surely emerge.

- English teaching institutions will not be affected by the withdrawal and removal of English test from college entrance exam.

In December 2013, the Ministry of Education posted a message on its website, announcing that it had finalized a general program for reforming the university exam and recruitment system, which sets out rules for classified tests, comprehensive evaluation, and admitting students with diverse qualifications. The highlight of the program lies in reform to the English test. Currently available information reveals that the English test will be removed from the national college entrance exam. That might have a major impact on the prevailing English teaching system. The follow-up implementation of the program has become a focus of attention.

Beijing: The English test score will be reduced by 50 points, and students will also be allowed to take two exams a year. The Framework Program for Reform of the University Exam and Recruitment System 2014-2016, published by the Beijing Education Commission, gives less weight to the English subject in Beijing's college entrance examination, stipulating that the English test score will be reduced from 150 to 100; that English exams will be offered twice a year, and that examinees can take multiple resits, with their best result in three years counting toward the final score.

Shanghai: There is no set timetable for reforming the English test in its college entrance examination. It is business as usual for next year.

Shanghai is preparing a general program for the reform of its college entrance exam and recruitment system according to the direction of the central government and the Ministry of Education. Internal views are being sought at the moment, and public opinions will be solicited at an appropriate time. The reform program will be further refined for the approval of the Shanghai municipal government before its final release.

Impact: Despite the fact that the weight of English is reduced in overall college admissions scores, the current trend of Chinese students studying abroad seems to be continuing unabated, and their enthusiasm for English training remains unbridled. So the policy change will not have any major impact on the English training programs targeting students going abroad and people wishing to improve their workplace English proficiency. Beijing's new policy is quite likely to encourage students to pursue a higher English test score, as their best result from multiple tests will be counting toward the final score. Seen in this light, multiple tests or a single test, students' learning needs remain as great as ever. English language training schools will not be affected.

- According to the overall programming of China (Shanghai) Pilot Free Trade Zone, private education will be encouraged in social services fields.

In September 2013, the State Council released a circular on the overall programming of China (Shanghai) Pilot Free Trade Zone, sketching a general profile of the new initiative. Planning on financial, shipping, trade and cultural projects had been widely expected. What surprised many was that private education was to be introduced into social services fields.

Impact: The opening up of Sino-foreign private education institutions and vocational training institutions will benefit Shanghai's private education companies. This new rule may serve as an additional reference for the amendment of the Private Education Promotion Law.

1.4 Challenges Facing the Private Education Sector in its Further Development

- Policy: An amendment of the Private Education Promotion Law is urgently needed

As of February 2014, there had been a large number of education stocks in the A-share market, but none of them was truly private. Earlier, going public by merging with a shell company, Only Education Group had been hailed as a strong candidate for being China's first education stock. The Private Education Promotion Law provides that "private education is a form of public undertaking," and the Education Law also provides that no organization or individual may establish or run a school or any other education institution for profit-making purposes. Existing education legislation requires further amendment to support the development of the market economy. Offcn Future, Huatu Hongyang, Longwen, Juren, and Zhuoyue have shown their intentions to get listed in the A-share market, but have been so far left out of the capital market due to policy constraints.

- Technology: The development of Internet technologies is gradually revolutionizing education models

The development of the Internet is having a more profound impact on and changing China's education market. More and more online education platforms, tools, and content and service provision organizations are emerging. Meanwhile, leading Internet firms like Taobao, Baidu, and Jinshan are looking to this new field for growth. Tarena International, which is filing for an IPO, has built its lead in the IT training market segment by using an online synchronous teaching model, which allows it to tap into virtual classrooms to reach a larger audience without stretching the existing teaching resource and at reduced teaching costs.

The Internet's impact on private education is multifold. Training institutions, degree-oriented education and higher education are increasingly coming under the influence of the Internet. Every link of the private education industry must incorporate Internet-age thinking into its development strategy.

"I was a bit disappointed that the proposal of merging Shanghai Xin Nanyang and Only was rejected by the CSRC, but I believe this will trigger wide discussion on the Private Education Promotion Law, which will eventually lead to the law being amended to suit the development of private education."

—— Liu Changke, General Manager of Only Education

"We should use Internet-age thinking to consider our business."

—— Huang Senlei, President and CEO of Jinghan Education

"The advent of online education has torn through the university campus fence. It is therefore important that universities reconsider and reshape their relationships with society, so that they can fulfil the function of serving the public. As an important means of achieving internationalization of higher education, online education will become a hotly contested arena by institutions of higher education from around the world."

—— Chen Jining, President of Tsinghua University

- Market: Training institutions clinging to traditional models are facing greater competition risks.

In December 2013, a Shanghai-based chain training organization called Yisi went out of business as it had ran out of cash and had been over RMB 10 million in debt. Yisi was not alone: a Beijing-based training organization called Hanlin New Thinking also closed down without a warning at almost the same time. A wave of shutdowns is sweeping across local brands and national chains. The offline training market is reaching relative saturation. In first tier markets, intense competition, difficulties in recruiting students, rising costs and the impact of the Internet-based education models are challenging conventional business models. Reckless expansion at this moment will spell disaster.

Offline training institutions should have a review and recap of the local demography, industries, consumer attitudes and their career development needs; and cater to multiple groups of potential clients and develop corresponding curriculums. On the back of a sound system and stronger cash flow levels, they can expand to other locations. This is a process that all

private education and training institutions must go through in the early stage. For 2014, training institutions must get down to the implementation details.

- Brain drain remains one of the biggest challenges facing private education institutions

The education industry is characterized by stable cash flows and generous profits. Many small- and medium-sized startup teams are jumping into the bandwagon of the flourishing online education and have obtained substantial funding. Star teachers' quitting big educating institutions to form startup teams is both boon and bane for the private education industry. For the industry, such independent entrepreneurship brings innovation and fresh competition, and therefore should be encouraged. However, for individual training institutions, this means a brain drain and disintegration of the team, which undoubtedly will cost them dearly. Training institutions must fully develop their core competitiveness, improve management and internal control, and raise the barriers for the competition to imitate, so as to survive and thrive in the intense market competition.

table 3: Star teachers of offline education institutions are leaving for online education fields

Teacher's Name	Previous Employer and Role	Resignation Time	New Employer
Zhang Xiaolong	Star teacher specializing in essay writing in civil service qualifying tests, Huatu Education	August 2013	quantiku.com
Le Jing	Most experienced IELTS teacher, New Oriental	June 2013	YY Online Education; Le-edu
Mei Han	Teaching director, Naturelaw International	June 2013	YY Online Education
Wei Xiaoliang	President assistant, New Oriental Vision Overseas Consulting	May 2013	smartpigai.com
Qu Shaocheng	Star oral English teacher, New Oriental	May 2013	smartpigai.com
Zheng Renqiang	Star teacher, Global IELTS	May 2013	YY Online Education
Zhang Chao	General Manager of the Overseas study department, Education International Cooperation Group	January 2012	ShareWithU
Ma Jun	Director of the North America VIP Program, New Oriental	July 2011	Self-employed, founder of xiaoma.com

Chapter 2. Diversification of China's Private Education

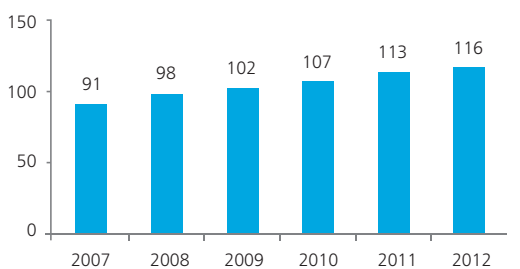
In the last two decades, China's private education has gone from a boom period of rapid development to today's consolidation phase. Both private schools and training institutions should start to implement lean management in place of extensive operations, paying more attention to the diversification trend of the industry. Meanwhile, they should attune their operational philosophy to the latest developments in Internet technologies.

2.1 Private Schools' Diversification Path

- Current status of international schools

In recent years, international schools have increased in number in China. This chapter focuses on international primary and secondary schools ("international schools") to analyze the diversification path of private schools in general. According to International School Consultancy Group, in the past 12 years, the number of international schools registered in mainland China has increased from 22 to 338, a CAGR of 25%. It is expected that the number will be close to 500 by 2015, taking into consideration international programs run by public schools. The driving force behind such growth is Chinese parents' need for a diversified education for their children as they get richer. China's existing exam-oriented system can no longer satisfy students and parents' long-term needs for quality education. International schools, with featured curriculum and courses that prepare students for further studies in overseas universities, have been thriving.

Graph5: Schools for Foreigners' Children Approved by the Ministry of Education



Source: www.askci.com, Collated by Deloitte

Currently, international schools have expanded their business scope to recruit more than foreign students. Specifically, they fall into the four categories:

Category 1: International schools run by foreign institutions, foreign-funded enterprises and branches of international organizations in China legally established in China, or foreigners legally residing in China ("Foreign-established international schools"), such as Shanghai American School and Western Academy of Beijing.

Category 2: Schools that admit both Chinese and foreign students, such as Alcanta International College, Beijing World Youth Academy, and Oxford International School of Changzhou. These schools use international curriculums and have independent campuses; they are international, in terms of their teaching philosophy, infrastructure and the composition of students.

Category 3: International programs run by local schools. These programs offer Advanced Placement and A-Level courses exclusively to Chinese students in a traditional Chinese classroom, following Chinese teaching philosophies. Strictly speaking, they do not count as international schools. Students attending such programs share the same infrastructure and teaching resources with regular students (who aim for Chinese universities), and take part in the student council and other community activities.

Category 4: tutoring centers run by foreign institutions or individuals.

China's international schools are mostly based in Beijing, Shanghai and Guangzhou. There is a positive correlation between the number of international schools and a city's speed of economic growth and its size of the population.

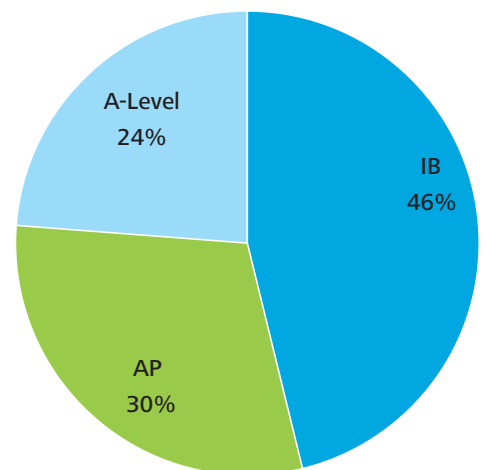
Table 4

Top 10 Provincial Capitals and Municipalities with the Largest Number of International Schools				
No.	City	No. of International Schools	Private	Public
1	Beijing	69	41	28
2	Shanghai	39	30	9
3	Guangzhou	20	11	9
4	Chengdu	15	7	8
5	Nanjing	11	8	3
6	Hangzhou	11	5	6
7	Shenzhen	8	7	1
8	Tianjin	8	4	4
9	Chongqing	8	5	3
10	Shijiazhuang	7	2	5

Source: Sina Education, Collated by Deloitte

International schools that recruit Chinese students are required to follow China’s compulsory education rules in designing curriculums for primary and secondary students, but they can be relatively flexible when designing high school curriculums. International high schools’ curriculum largely comprises Chinese courses, language courses and international courses, which include IB, A-Level and AP courses. In theory, these three courses help student apply for prestigious universities around the world. Students are advised to choose schools based on their intended universities. Those who choose to study in the U.S. should go to schools that offer AP courses, which are overseen by the College Board; those choosing the U.K. should take A-Level courses, which are hosted by University of Cambridge Local Examinations Syndicate. IB courses are developed by the International Baccalaureate Diploma Program, and with an IB diploma, students can apply for universities in many western countries. According to Sina Education’s rough estimation, IB courses are offered in the majority of China’s international schools, accounting for around 46 percent of all, followed by AP and A-Level courses.

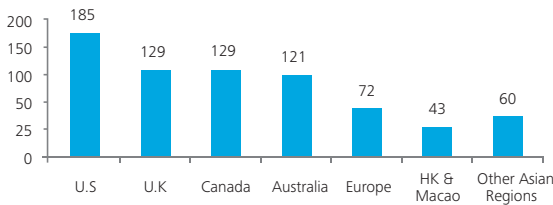
Graph6: Courses Offered by International Schools



Source: Sina Education, collated by Deloitte

The U.S. still tops the chart of the most popular destinations for Chinese students, followed by the U.K. and Canada. Australia ranks a close fourth. These four English-speaking countries are Chinese students' top choices.

Graph7: Most Popular Destinations Targeted by International Schools



Source: Sina Education, Collated by Deloitte

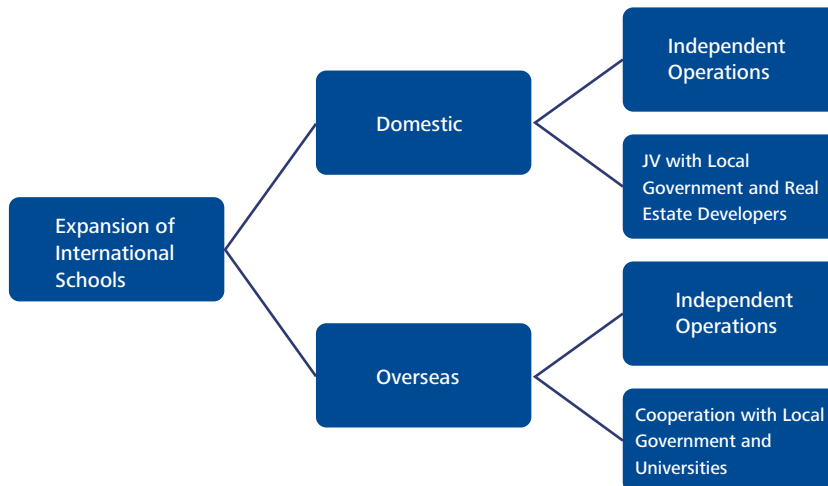
- International schools' diversified path of growth

For International schools, the barrier to entry is very high, as they have long education cycles, and they must meet the government's rigid requirements for the campus area and facilities. So they are still in their infancy, and they are diversifying largely through regional expansion.

They may go about regional expansion by establishing branches either in China or overseas. When establishing new branches in China, they have to consider the local economic conditions, educational needs, management of teaching resources, and the needed space for the campus. International schools used to buy land from the local government at discount prices. But now, rising land prices have made this method too expensive, and they are opting for Chinese-foreign joint venture schools. Dalian Maple Leaf International School, for instance, has been using this approach to expand its market over the last two years. It contributes brand and management expertise, while its partners – local governments and real estate developers—contribute land tenure and campus, respectively. This arrangement greatly reduces the cost of land on the part of Dalian Maple Leaf Education Group.

International schools should also fully tap into the effective demand in the local market, and make better use of the brand clout and resources. For example, on top of primary and secondary programs, they can offer kindergarten and pre-school courses; they can also provide students intending to study abroad with more value-added services. Such efforts help boost brand recognition and increase students and their parents' stickiness to the school.

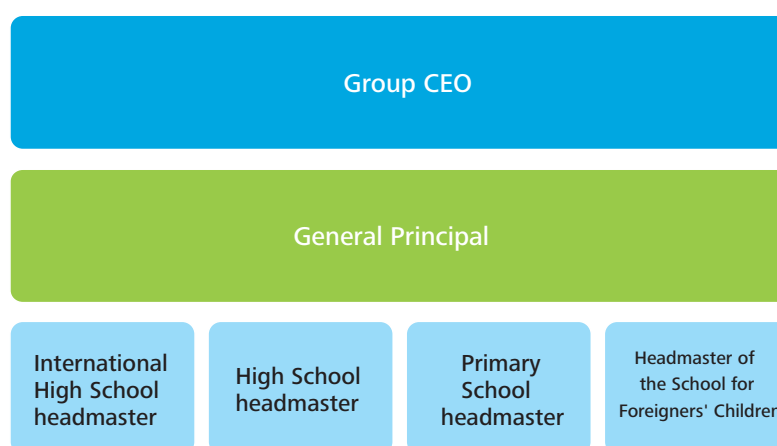
Figure3: International Schools' Regional Development Models



Source: Deloitte Research

While they expand at home, international schools must consider replicating their management models and experience as soon as they have the needed human resources. For example, Dalian Maple Leaf has two superintendents, responsible for designing Chinese and Canadian courses; steering and assessing curriculum teaching; and reporting to the President's Advisory Council. All of its branches use the same textbooks, to ensure that students are exposed to the same content. Every campus contains multiple schools – primary, secondary and high schools. Some even have schools for foreigners' children.

Figure4: Management Structure of Dalian Maple Leaf, Wuhan Branch



Source: Publicly-available Information, Collated by Deloitte

The general principal assumes overall responsibility for the administration of the school, and reports to the president of the group, while headmasters at every campus report to the principal. Operationally, finance, human resource and logistics report to the schoolmaster as well, but functionally, they report to the president of the group through a uniform management system. Such a management structure ensures standardization of the curriculum system, resource optimization and reduced operational costs through economies of scale, thus making the group successful.

On the other hand, China's international schools have just begun to go global. As China continues to grow and its communication with the world intensifies, the world is placing a greater demand for China's education. For example, by 2012, the Confucius Institute, a non-profit initiative launched to teach Chinese and spread Chinese culture across the world, had established over 400 branches and over 500 Confucius classes for primary and secondary school students in 108 countries. In 2006, Huijia Educational Organization established Chinese International School in Singapore, and is establishing more schools in the U.S., Australia and Germany. In 2011, Dalian Maple Leaf Education Group entered into a partnership agreement with Camosun College, under which Dalian Maple Leaf would run a school in Canada independently using Camosun's resources.



2.2 Training Institutions' Diversification Path

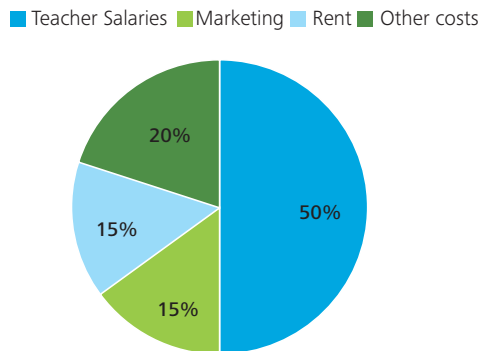
- Coping with rising costs through diversification

The rapid development of the training market – at an annual rate of 25 percent – in China in the last decade has been driven by the country's fast-growing economy and expanding demand in the education market. Business groups that entered the market early have established learning centers and reinforced their brand standing through more powerful marketing. Some have replicated their successful models in other economically advanced cities using financing vehicles. All these years of rapid expansion have seen the emergence of some leading brands in every segment of the training market. Now, education and training groups need to consider their next step forward, as the Internet threatens to upend conventional models.

Surveys show that teachers' compensation, marketing and rent represent the chunk of the management costs for most training institutions. In recent years, teacher pay and rent have been rising, posing great challenge for their operations. According to data released by Wind, Beijing's prime office buildings rose 78 percent in 2013 compared with 2010. In Shanghai, prime rents grew by 14 percent during the same period; and in Guangzhou and Shenzhen, 30 percent and 33 percent, respectively. Teacher salaries and marketing costs keep rising at 10-20 percent annually.

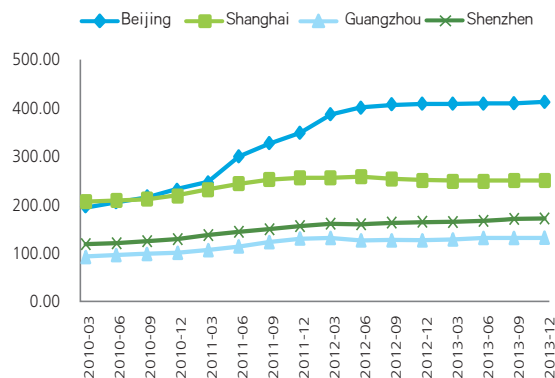
To cope with the rising costs, training institutions should try to improve their efficiency through a number of measures. See figure below.

Graph8: Training Institutions' Cost Breakdown



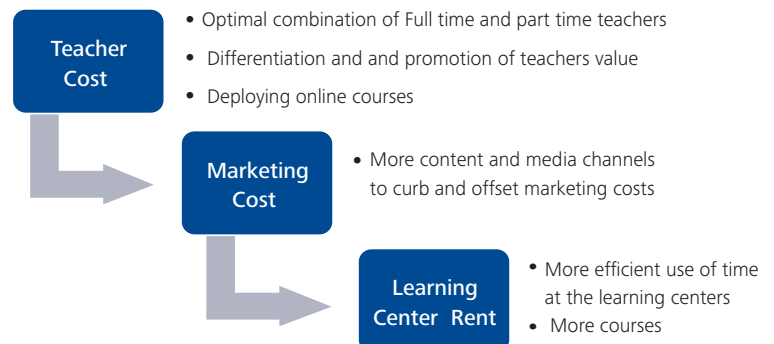
Source: Deloitte Research

Graph9: A Comparison of Prime Rents in Big Cities (RMB/Month/ m²)



Source: Wind, Collated by Deloitte

Figure5



Source: Deloitte Research

- Diversified investment to address challenges of the Internet

In the face of the sizzling hot online education trend, training institutions should integrate the Internet into their growth strategy. The Internet has already dealt a heavy blow to the retail, banking and service industries. And its simmering technological evolution is about to reach a tipping point soon, threatening to turn conventional training institutions on their heads. Offline education does have many irreplaceable characteristics, but 2014 will be a watershed year for the industry, when online and offline channels merge. This may happen first in a certain training institution, since it is standardized products and business models with short processes that are most vulnerable to the Internet's shock.

Investment in online education through M&A can minimize the impact of the Internet. A case in point is TAL Education Group, which has completed its expansion into the online sphere through multiple M&A deals. It entered the pre-school online education market by acquiring in BabyTree; has indirectly reduced operational costs and increased experience by controlling jmdedu.com, one of the leading media sites in the industry; and has accumulated useful experience in live web streaming of lectures through investment in duobei.com. TAL's M&A within the industry, especially in online education, has helped it achieve growth in a comprehensive yet measured way.

Table5: Investments Made by TAL Education Group

Date	Iconic Companies Acquired	Industry	Transaction Amount (in 1,000 USD)	Equity
January 28, 2014	BabyTree	A website on maternal and child care	24,150	N/A
January 1, 2014	jmdedu.com	A new media site in the education industry	N/A	N/A
December 5, 2013	kaoyan.com	An information publishing platform dedicated to postgraduate entrance exams	8,500	N/A
October 1, 2013	duozhi.com	A professional media site dedicated to private education	N/A	N/A
July 15, 2013	duobei.com	A website offering videotaped lectures	3,080	16.85%
February 28, 2013	ilizhi.com	An education service institution offering a variety of experience packages to teenage customers	2,410	6.00%

Source: CVsource, Deloitte Research

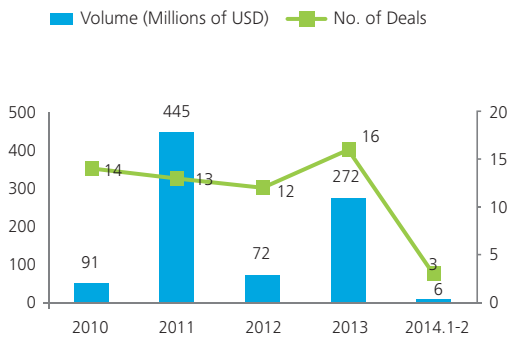
2.3 China's Private Education Groups are Active in M&A

The diversification of the education industry has been driven by M&A. The year 2013 saw a record high of 16 deals, worth a total of 272 million USD, compared with 445 million USD in 2011. As education and training institutions grow, the industry will become increasingly concentrated. M&A is expected to remain active in 2014, as the private education market matures.

In 2013, 98 percent of the industry's M&A deals happened at home.

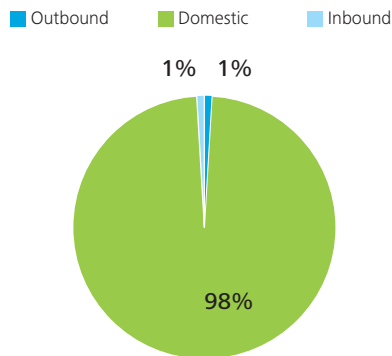
On the demand side, education groups accounted for 50 percent of the deals; Internet firms, 6 percent; and institutional investors from outside the industry, 44 percent. By deal volume, 59 percent were from institutional investors, and the rest 41 percent, education groups. As the time when this report is prepared, no data was available on the volume of deals by Internet firms.

Graph10: M&A in the Education Industry



Source: CVsource, Deloitte Research

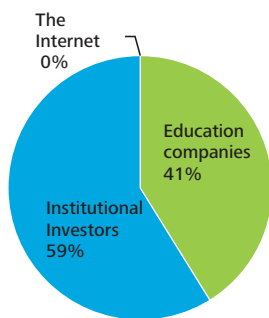
Graph11: Types of M&A Deals in the Education Industry 2013(By Volume)



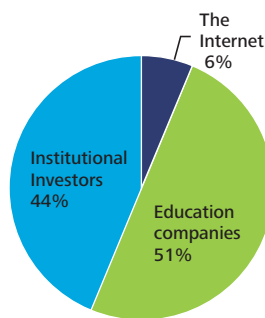
Source: CVsource, Deloitte Research

Graph12: Buyers in the M&A Transactions 2013

By Amount of Transaction



By the No. of Deals

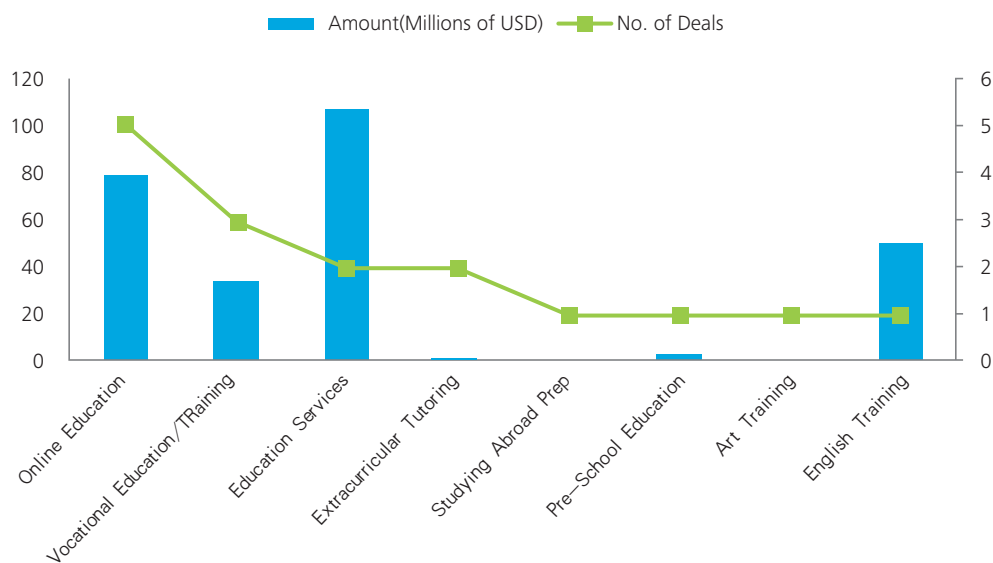


Source: CVsource, Deloitte Research

In 2013, the largest number of M&A deals happened in the online education market segment, followed by vocational training. By the volume of deals, education service was the largest segment, followed by online education. These features support the view that diversifying product offering through M&A is a convenient and easy-to-follow pathway to rapid development.

Education institutions should adjust and coordinate their operations following M&A. What matters is not the number of deals they make, but the potential synergy between new and existing businesses. A new business should be a beneficial supplement to the existing core products, or help the core curriculums attract potential customers or expand market. Effective management of a new addition is a big challenge. Dalian Maple Leaf international school dismissed the franchise model altogether, lest that franchises may damage the group's reputation – particularly vital for an education company –

Graph13: Sellers in the M&A Transactions 2013



Source: CVsource, Deloitte Research

Chapter 3. Internet in China's Education Market

In recent years, the traditional offline education has been challenged by soaring office rents and labor costs. The diverse needs of consumers have been inclining the teaching structure towards smaller class sizes and more VIP services. In this context, the training industry is confronted with increasingly noticeable challenges like higher costs, lower revenues, and difficult promotion of prime examples. The popularity of the Internet and smartphones has led to remarkable improvements on the mobile tools and the Internet environment as a whole.

The traditional education has its limitations that have fueled growing demand for personalized learning, which is increasingly extending to other areas. Thanks to the national curriculum reform, local education infrastructure, and virtual campus initiatives, online education has been widely seen as having the huge potential for growth.

The mobile Internet technological advance and massive market investment have contributed to the accelerated growth of online education, especially that on mobile platforms. According to Deloitte Research, statistics show that an average of 2.3 online education companies were registered in China in 2013. From 2013Q1 to 2014Q1, more than 30 such companies, in China and abroad, received investments. However, unlike the U.S. competitors boasting hundreds of millions worth of investment, Chinese online education companies are mostly backed up by angel investors with smaller financing contributions.

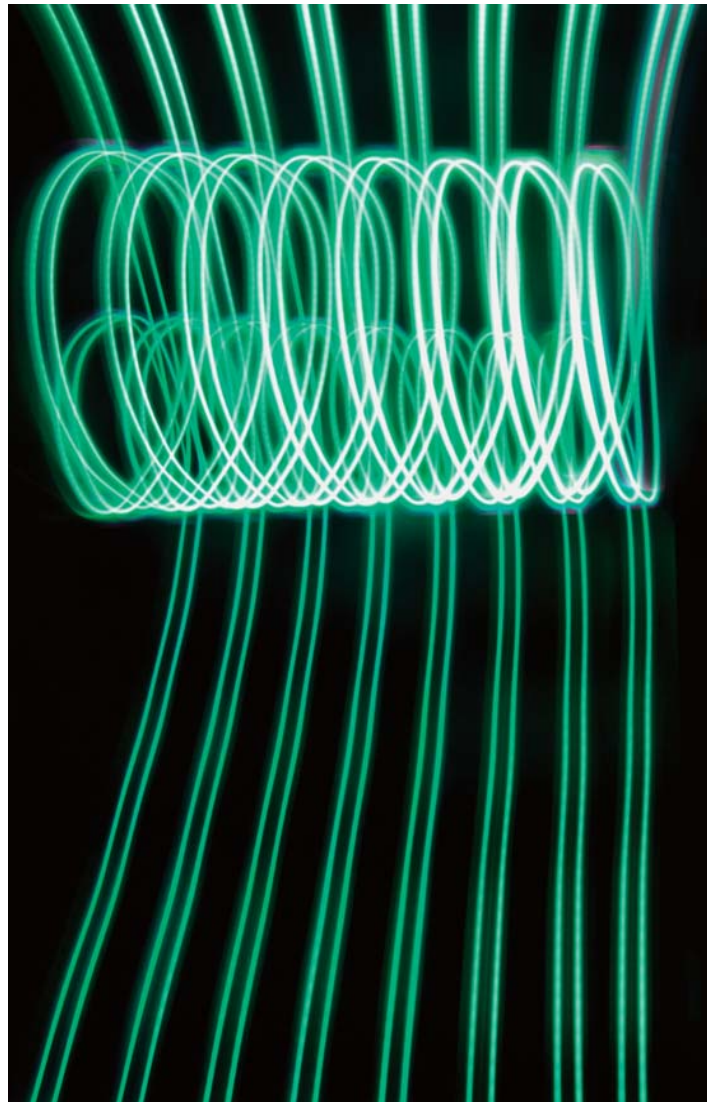


Table 6

Investment in Online Education					
Period	Company	Business	Investors	Financing Amount	Financing Rounds
2013Q1	Lynda	Vocational Education	NA	\$103 million	Venture Capital
	Pluralsigt	Software Courses	Insight Venture	\$27.5 million	Venture Capital
	Babbel	Multimedia Teaching	Reed Elsevier Ventures	\$10 million	Series B
	Studyblue	eSchoolbag	Great Oaks	\$9 million	Series A
	CreativeLIVE	Creative Education	Creative Artists Agency	\$21.5 million	Series B

Investment in Online Education					
Period	Company	Business	Investors	Financing Amount	Financing Rounds
2013Q2	AlO7	Childhood Education	Qualcomm Ventures / Vickers Venture Partners	\$20 million	Venture Capital
	WYZC	Vocational Education	ZhenFund	\$2 million	Venture Capital
	Yingding Education	Pre-test Training	Golden Rock Venture Capital	¥ 30 million	Venture Capital
	51Talk	Oral English	ZhenFund	\$2 million	Venture Capital
	Yinghe Edu	Learning Platform	TBP Capital	\$5 million	Venture Capital
	XSTeach	IT Training	NA	¥15 million	Venture Capital
	91wajiao	Oral English	NetEase	\$4 million	Venture Capital
	YuanTiKu	Test Library	NA	\$3 million	Venture Capital
	DuoBei	Tools Platform	Tomorrow Advancing Life	\$3.08 million	Venture Capital
	EachBaby	Early Childhood Education	Hejun Capital / Easy Capital Partners /PreAngel Investment	¥10 million	Venture Capital
	Hujiang Class	Socializing	NA	\$23 million	Venture Capital
	Super Course Schedule	Campus Socializing	Sequoia Capital / ZhenFund	Over ¥ 10 million	Venture Capital
2013Q3	ChuanKe	Tools Platform	Baidu	\$2 million	Strategic Investment
	YuanTiKu	Test Library	Matrix Partners China / IDG	\$7 million	Venture Capital
	Iwmgh	English Vocabulary Learning	China Growth Capital	¥ millions	Venture Capital
2013Q4	LiuLiShuo	Oral English	GGV Capital	\$ millions	Venture Capital
	KaoYan	Postgraduate Preparation	Tomorrow Advancing Life	\$ 8.5 million	Merger
	More Fun, More English	English Vocabulary Learning	Gobi Partners	¥ 8 million	Venture Capital
	Clever	Data Interface	Sequoia Capital	\$10 million	Venture Capital
2014Q1	Open Sesame	Training Program Search	Partech Ventures	\$8 million	Series A
	Baby Tree	Maternity & Infant Care	Tomorrow Advancing Life	¥ 150 million	Strategic Investment
	100 Online Education	Studying Abroad	Huanjun	NA	Business Demerger
	Renaissance	K12	Google	\$40 million	Venture Capital
	2U	Higher Education	IPO	\$100 million	Listed
	Duolingo	Language Tools	Kleiner Perkins	\$20 million	Series B
	China Distance Education Holdings Limited	Vocational Education	Additional Shares Issuance	\$120 million	Additional Shares Issuance
	Junteng International	Audio Teaching	Tencent	30% ownership	Angel Investment
	VIPABC	Oral English	Alibaba / Temasek / Qiming Venture Partners	\$100 million	Series A
	Tarena	IT Training	IPO	\$100 million proposed	Listed
KaiKeBa	General IT Platforms	Fosun Kunzhong Capital	\$20 million	Series A	

Source: Soho Education, Collated by Deloitte

3.1 Development of Online Education

After the integration of industries like shopping, tourism, and socializing, all triggers of huge demands, into the Internet, education and healthcare are the last remaining popular, marketized industries.

The Internet was introduced to the education industry over a decade ago, when distance learning, online schooling, and online marketing dominated the dynamics. Characteristics like huge market potential, fierce competition, and distinctive decentralization have ensured that the online marketing for the education industry has been attracting the undivided attention of institutions. In 2012, Baidu reported revenues of over RMB 4 billion offering keyword search services for the education industry. Such scattered yet huge network traffic has provided the theoretical foundations for the majority of start-up platforms at this stage.

Meanwhile, the unbalanced distribution of educational sources and prestigious teachers has encouraged the emergence of online educational services like www.chinaedu.net, www.chinaedu.com, and www.hgznedu.com. However, the unsatisfactory delivery of videotaped services and the lagging household Internet access have held back such inevitable trends.

In April 2013, the Ministry of Industry and Information Technology and the National Development and Reform Commission, together with other competent authorities, announced a joint statement, Opinions on Implementing the "Broadband China" Project 2013, and explicitly envisioned an addition of 180,000 3G base stations, an increase of 25 million households connected to the Internet via fixed broadband, Internet access for 5,000 elementary and middle schools in impoverished rural areas, and implementation of the broadband infrastructure that connects education facilities to the Internet.

Currently, the online education has been accelerated by the popular use of mobile devices and maturing Internet technologies. Better possibilities for live teaching and "anytime, anywhere" studying have been explored by the high-speed broadband and 4G technologies.

- Government support

Education reforms are normally considered at national levels. When it comes to online education, Korea announced the disposal of paper textbooks starting in 2015, Japan has been granting distance education up to 60 credits out of the total 124 required for a bachelor's program since 1998, and U.S. President Obama said in 2013 that he wanted to connect 99 percent of America's students to high-speed broadband Internet within four years. In recent years, the Chinese government has been more open-minded about the private education industry and values information technologies in achieving equal access to education and sharing of educational resources.

According to the strategic visions stated in the National Outline for Medium and Long-term Education Reform and Development (2010-2020), the Chinese government has been building the Open University of China, and enacted the Rules of the Open University of China. Meanwhile, the Ministry of Education has been moving forward with massive open online courses (MOOC), and asking its Project 985 universities to offer such courses and providing them with subsidies.

In addition, the Outline also put forward the idea of "networked education", giving political support for the wider introduction of eSchoolbag, an educational network terminal. The State Administration of Press, Publication, Radio, Film and Television has expressively added eSchoolbag to its 12th Five-Year Plan. Later on, the Ministry of Education piloted the first eSchoolbag program of its kind in Hongkou District, Shanghai. The promulgation of Several Opinions of the State Council on Promoting Information Consumption and Boosting Domestic Demand, and the Notice of the State Council on Printing and Issuing the "Broadband China" Strategy and Implementation Plan has underscored the government's ever stronger determination to support the information industry, which adds to the popularity of the Internet-based education market.

- Start-ups emerging in large numbers

Currently, start-ups engaging in China's online education specialize in preschool education, K12, and foreign language teaching. Deloitte said that, among the top 200 bestselling education applications in China, preschool education takes up approximately 60 percent, an indicator of many Chinese parents using children-oriented software for preschool education. Determined not to have their children fail at the starting line, they have encouraged the explosive growth of such applications and made preschool education the most populated submarket for online educational start-ups. K12, however, is more complicated with

greater market potential, and thus the most contested submarket. Unlike foreign language teaching that requires autonomic learning, K12 involves the multilevel dynamics between students, teachers, and parents. Therefore, products are required to complete the closed-loop learning catering to the mentioned three categories of participants. In case of any need not duly considered or satisfied, client loyalty is undermined.

In terms of the nature of products and services, start-ups of online education are categorized according to tools platform, traffic platform, test library, online teaching by foreign nationals, online testing, vocabulary learning/oral practice, course scheduling, and terminal tools, as described below

Table 7: Business Categories in Online Education

Product/Service	Companies
Tools Platform	DuoBei; ChuanKe; TiZi; 17ZuoYe; DiJiuKe; 100 Online Education; Smart Study
Traffic Platform	Baidu Zhixin (Education); Taobao Xue; Jue Sheng
Test Library	YuanTiKu; ZhuanTiKu; TiFen; 91UP
Online Teaching by Foreign Nationals	VIPABC; 91WaiJiao; 51Talk
Online Testing	SmartPigai
English Vocabulary Learning	BaiCiZhan; lwmgh; toWords; ShanBay
Oral English Practice	LiuLishuo; YingYuShuo
Course Scheduling	Super Course Schedule; Class Box, and ; ClassTable
Terminal Tools	Ozing; Noah; XueZhiLang

Source: Deloitte Research

- Internet giants on the move

In the past year, the sophisticated Big Three, Baidu, Alibaba, and Tencent, or the BAT as dubbed, together with Internet companies like Qihoo and NetDragon, entered the education market. Baidu exploits its core advantage – search services – and builds up its search capabilities on mobile devices with the acquisition of 91 Wireless, once one of China's largest app stores for Android. Alibaba secures its credibility of online education with its Alipay, the online payment escrow service. Tencent tightens its grasp of interpersonal socializing with its WeChat service. These Internet giants have searching perceptions of what the users need, and play a vital role in teaching them how to buy what they need. Their entry into online education is about to engage more competitors. At the same time, the massive traffic that goes through players like the BAT helps bring more users and traffic to online educational services.

Specifically, Taobao Xue is currently undergoing free-of-charge marketing, featuring courses either videotaped beforehand or broadcast live, and beginning with marginalized needs. Tencent specializes in introducing competitive courses of originality and pragmatism while adding basic education-based features like PPT to its lasted QQ (SP5), an instant messaging software service. Baidu Education strategically focuses on its Zhixin service in its bid to maintain the existing market shares and avoid being put on the defensive as they were in vertical markets like real estate and automobile. On the other hand, Baidu is investing in www.chuanke.com, hoping to grow or transfer the traffic on PC ends to its advantage.

Years of activity have given the traditional Internet giants and education-oriented companies remarkable advantages in terms of network traffic and scale effects. However, what the education business needs is personalization, which looks much closer at network traffic than other industries. Therefore, it's imperative to know what the users want and make sure it's transferred with precision.

- Traditional players building presence

Internet-based education is more and more considered as a general trend, which challenges traditional training agencies to initiate reforms in the face of the ambitious start-ups and marching giants.

After the Xueersi Group was renamed Tomorrow Advancing Life (TAL), the new group identifies itself as “a company dedicated to the development of education with technologies and the Internet” in its integration of traditional education and online teaching. Since then Xueersi and its online school have been operating as two parallel brands that conceived the Seaside project and put prestigious teachers on live broadcasting. In response to the K12 training market, New Oriental has developed a platform combining PC and mobile ends with offline classes. In FY 2014, the company is committed to expanding its presence in interactive learning platforms. Xueda Education is orchestrating its internal teaching resources and management system into a SoLoMo structure – social, local and mobile – and gradually putting its offline operations online.

Traditional educational services have been the most unique participant in this campaign. Unlike start-ups, they're in possession of astonishingly abundant resources. In contrast with Internet companies, they have a firm grasp of an even richer collection of teaching information. As for the weak link, at present, they're sometimes trapped in a dilemma when they're going for online pilots and offline expansion at the same time. Meanwhile, prestigious traditional educational services are mostly public companies, which forces them to balance long-term investment against short-term shareholder returns when it comes to online business.

“In the future, I think what I call 'ground' education will make up about 60 percent of the total training and education activities, leaving 40 percent for online education. This is what happen in three to five years...”

—— Yu Minhong, Chairman & CEO,
New Oriental Education & Technology Group Inc.

3.2 Challenges to Internet-Based Education

Mostly born in the 1970s and 80s, parents of school-age children are more open-minded about the Internet – a fact undermined by the test- and result-based teaching mentalities, which are oriented to academic performance as a major determinant of the selection and assessment of educational activities. The Internet-based education is much challenged for the delivery of academic excellence as well as the satisfaction of client needs.

- The K12 market is as much favored as it's constrained by client availability and their willingness to pay.

According to the statistics from the Ministry of Education, by 31 December, 2012, there had been 210 million students studying at elementary and middle schools, which represented a huge demand in the K12 market.

Statistics show that the extracurricular tuition industry is expected to hit 32.5 billion USD or RMB

200 billion in 2014, in stark contrast to the online training market valued at RMB 300 million or, hundreds of times smaller than their brick-and-mortar competitors.

Despite the pricing advantages brought by the Internet, any mistake comes at devastating cost to K12 children due to the one-way nature of their growth, which explains the insensitivity of their parents to prices. Education-related spending accounts for one seventh of the incomes of China's middle class. Fifty four percent of Chinese families spend more than RMB 2,000 a month on extracurricular learning.

It's worth mentioning that K12 students in China are short on time assigned to extracurricular activities, which forces online educational services to fight for their availability against the offline institutions. Education is a service system that attaches utmost significance to results. There's no way parents prefer trivial considerations like better transportation or lower tuition fees over promises of academic excellence.

Table 8

Students in 2012 (thousands)				
	Graduated	Enrolled	On Campus	Total
Undergraduate/Junior College	6247	6888	23913	30801
Adult Undergraduate/Junior College	1954	2440	5831	8271
Online Undergraduate/Junior College	1361	1964	5704	7669
Senior High School	7915	8446	24671	33118
High School	16608	15708	47631	63338
Primary School	16416	17147	96959	114106
Pre-school Education	14336	19119	36858	55978

Source: Wind, Collated by Deloitte

- Online education remains stagnant in creating content.

In early discussions about the Internet-based education, comparisons between China and the United States were more than often brought up, among which the most dominant ones being the better digitalized teaching environment and more satisfactory supporting system besides good infrastructure. U.S. public companies specializing in education mostly comprise institutions of higher education. The Washington Post Company, for example, operates on revenues mainly generated by its subsidiary, Kaplan, Inc., an educational expert. In addition to its university brands, Kaplan is leading in Chartered Financial Analyst (CFA) training, and owns prestigious educational content providers like Becker and ETC

The private education market in China, on the other hand, has been struggling at the lower end of the industrial chain, shackled by the government's heavy hand on examination guideline and the longtime lack of protection of intellectual property rights. In China, education companies are basically working on test preparations and importing foreign content. They're lacking in the capability to independently develop content on a large scale. That's why the emergence of online education hasn't yet come with the required soft content despite the rapid progress in hardware building.

Online education distinguishes itself from traditional education in terms of learning methodologies, routes, and habits. The online school model relocating offline content to the Internet has proved to be unsuccessful in satisfying consumers. Content creation has become a bottleneck given the online education industry's weak links in this regard as well as the talent gap and unbalanced educational geography.

- Profit strategies remain ambiguous, and teaching assessment as well tuition collection challenged.

The Internet in China has been long labeled as a free cake. Recently, 100 Online Education, owned by YY, a major Chinese video-based social network, announced that it would give away its TOEFL and IELTS programs for free, a move to initiate a campaign of free education. But then again, the attempt wasn't the first of its kind in the education market – New Oriental, in its early days, engaged its students by hosting free lectures before asking them for money. Efficiency in turning the Internet-based education into a paid service is more decisive.

Compared with client loyalty and premium services, the long-term loyalty towards online courses represents a bigger challenge. While activities like interest-based courses, socializing, and shopping are seen as regular needs, the demand for educational products is more fractured over a certain period of time. The continuity of client's interests turns out to be the toughest test. If tests are to be the focus, results once again become the main benchmark. Lack of the compulsory nature and sufficient content creation has discouraged the objective and sensible assessment of teaching performance.

3.3 Way Forward and Opportunities

A lot of thinking needs to be done on the fact that, despite the prevailing boom in online education and its capital investment, its delivery and paid subscriptions are hardly satisfactory. Few of the service providers remain in the black, and the industry isn't yet an economy of scale.

Online education represents a change of the educational methodologies. Technically and strategically speaking, the Chinese market is scarcely lagging behind. The biggest gap is found in the self-motivation of the students and their willingness to pay. That being said, market opportunities don't come naturally as the result of social mindsets giving in to products. Just because the online shopping sites were shouting "Let's show some credibility" in their early years, doesn't mean they had to be favored – what was needed is an enabling solution like Alipay.

Services

The chronic predicaments of the educational services are in a way owed to the separation between the buyer and the user. It's surprising that parents as the dominant decision maker are hardly involved in any part of the teaching process. The Internet, instead, facilitates interaction between schools and parents, and applies the synergy with family education to improve teaching results, making up for the information asymmetry. In this context, XiaoXunTong, the flagship service by Qtone Education, was introduced as a bridge between parents and schools.

O2O

The online education is expected to inevitably offer the 101 courses for free and charge its premium services. Models like test libraries, online Q&A, and discussion communities are gaining momentum, while part of offline institutions' functions are realized on the Internet. The structure releases the labor space occupied by offline players to the improved effectiveness and efficiency with more personalized premium services.

Socializing

Group scope and internal interaction are very important to the continuous contribution of clients. A successful platform doesn't only rely on a big group size, but also on adequate exchange of ideas the only way that inspires group members to pursue a collective reputation and seek other motivations to add value to clients and deliver content.

MOOC

In the long run, there's a prevailing scarcity of educational resources in China, where elite universities offer degree-oriented programs through open online courses. When it comes to higher education, as students have been already divided by test standards, it becomes more easily acceptable to sign up for a "slightly different" program for lower fees.

Content providers

The Internet-based platforms facilitate the delivery of content, and add to the improvement of the industrial chain. Providers of content, platforms, and distribution networks are clearly identified, pushing content creators to the center. That said, the prospects are fundamentally premised on the improving landscape of intellectual property protection.

Vocational education

Over the past decade or so, vocational education in China has been clustered in training of technical skills, like cooking and automotive repairing. As individual industries are developing and the job market breeding intense competition, vocational education of advanced degree holders and employed staff is becoming a bigger priority for the government, companies, and social organizations. Since the employed population is more financially flexible and willing to learn, they have become a prime target for online learning services. Given the preferential policies and growing demand, the spotlight needs to be turned on such developments.

Applications

On the mobile end, there's a surprisingly wide range of educational applications based on "anytime, anywhere" learning, like English vocabulary learning and test libraries; audio services, conversational and listening English practice; animations and games designed for children; and advertised premium services.

In conclusion, online services are at the forefront of China's educational informationalization drive as its fastest growing constituent part. The rapidly expanding scale has been changing how people see and buy educational products, and attracting the attention of industry practitioners and venture capitalists. The most urgent priority is the effective integration of educational resources and Internet technologies in the constant pursuit of highly interactive and personalized services and products, where client loyalty is to be strengthened and the follow-the-leader mentality as well as impulsive investment avoided.

Chapter 4. Reflections on Education Industry in China

Since 2013, China’s education industry has entered a new phase of integration, confronted with new challenges. Deloitte has identified three hot topics hoping to inspire more discussions about the industry.

4.1 Can technicians be put on an equal footing with academicians?

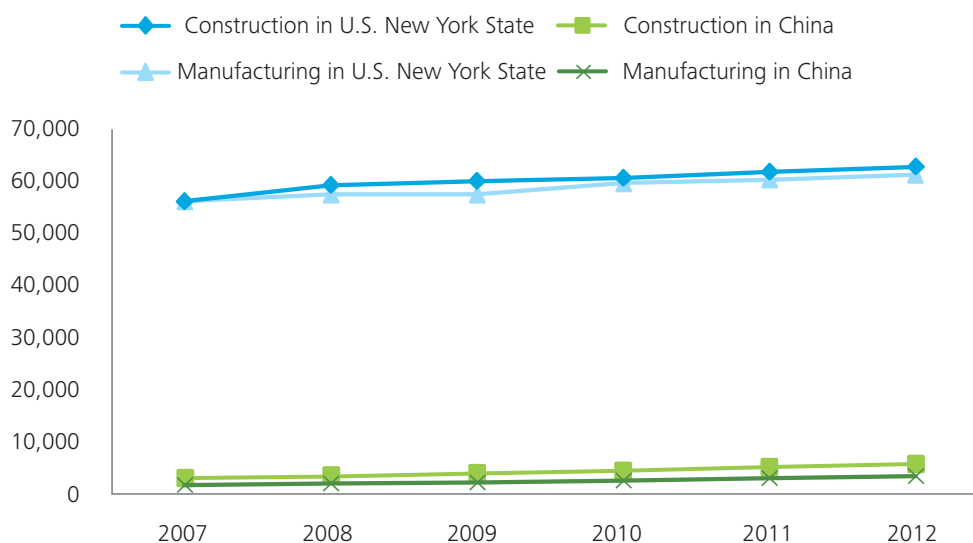
[Background]

At the China Development Forum in March, 2014, the Chinese Vice Minister of Education, Lu Xin, indicated that the government was planning to introduce a college entrance examination for vocational education – made up of both academic and vocational tests, designed for would-be technicians – to complement the existing academia-based talent selection system. In short, future technicians and academicians are to be separately tested for college entrance. The Ministry of Education plans to encourage over 600 universities to prioritize vocational education that’s built on the application of technical skills. However, it remains a good discussion about whether highly skilled technicians are as much recognized as academicians.

[Yes]

Where the education industry goes is a reflection on economic needs of a country. On the bright side, China at present is undergoing the upgrade of manufacturing industry, and its success depends on the availability of experienced technicians. If the private higher learning institutions prove to be successful in finding openings for vocational education and thus delivering qualified technicians, they can almost certainly make a leap in the reshuffle. China’s economic advance has elevated the social status of laborers and consequently increased their incomes. According to comparisons of average wages in construction and manufacturing in the U.S. New York state, highly skilled technicians or general laborers are expecting due rises in average wages. It’s also anticipated that the skilled labor force will be more favored by corporate employers and occupy a higher seat than academicians up the social ladder.

Graph14: A Comparison of Average Wages in Construction & Manufacturing in China & U.S. (\$/year)

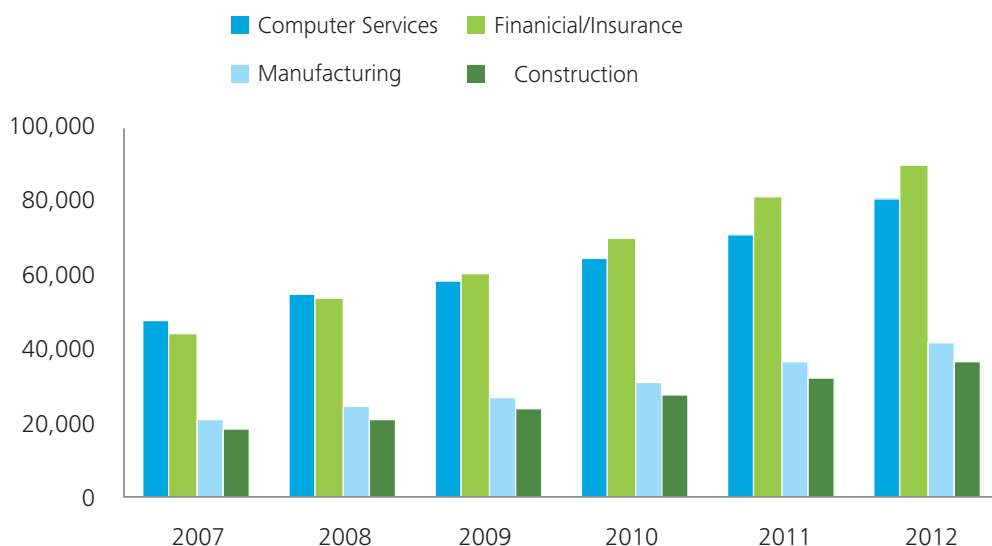


Source: Wind, Collated by Deloitte

[No]

On the reverse side, China's vocational education is most troubled by little social recognition, which discourages the talent during the admissions procedures. It takes a long time before a technician is properly trained and qualified as good one. In the process, that part of recognition is badly needed. In the current vocational education system, skilled technicians – already high income earners – are not treated as equals with academicians. It takes at least five more years for average laborers to see remarkable income increases. Then, results of vocational education and its social rank can be expected to be acknowledged.

Graph15: Average Wages in Non-private Entities in Urban China(RMB/year)



Source: Wind, Collated by Deloitte

[Deloitte Perspective]

Speaking on the reform of vocational education, the Chinese Premier, Li Keqiang, said that "The vocational education must satisfy the market, which should be well catered for by technicians. We're looking at the public opinion that's not obsessed with academic titles but open-minded about professional competencies." If China's education system gets rid of its academic title obsession, learning is no longer about earning a degree, but a process leading to the true value of education itself. When the time comes, the talent assessment system can be practically reshaped. Until quite recently have begun the vocational education reforms, so the drive requires longtime, lasting commitment. Therefore, technicians are not yet on the same footing as academicians.

4.2 Can the era of online learning extend the value of star teachers?

[Background]

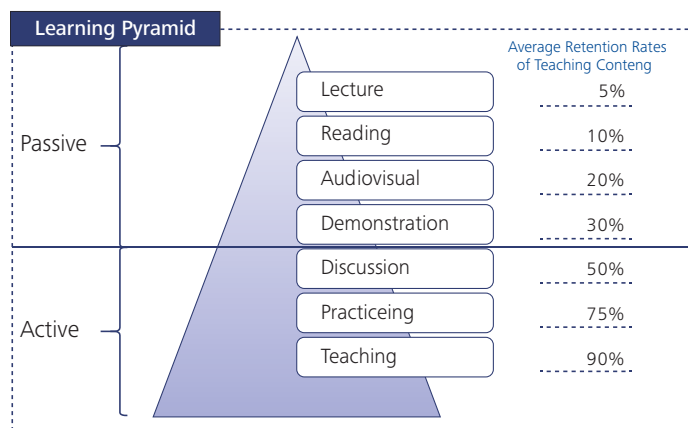
Online education finds favor with China’s capital market, which can be demonstrated by the recent 35 mergers and acquisitions in the past year. China’s online education is on the fast track to growth. In this context, how should teachers, especially ones in public institutions, respond to online challenges? Can their value be extended?

[Yes]

According to the learning pyramid, students are involved in a passive learning cycle, especially during the K12 period. They’re listening, reading, and watching to digest what is being taught. Although the retention rate of such teaching information is hardly high, face-to-face tutoring and supervision are required for most of the K12 students – all the more reach why classroom teaching is indispensable. Influences on students’ morality and their engagement in teaching activities can never be delivered on the Internet. The value of experienced, prestigious teachers will be extended as long as classroom teaching exists.

[No]

In an era of online education, teaching practices are dominated by the delivery of standardized information, complemented by discussion sessions and test preparation services, which altogether completes a teaching cycle. Admittedly, online education requires good teaching talent, though much less so when it comes to their reliance. Their satisfactory teaching results don’t necessarily speak up for success across the online landscape. A complete set of services is the real selling point that outruns the traditional business. Based on students’ feedback on the past year’s teaching, online educational service providers are able to be more targeted at updating their test libraries as well as presentations. Timely, professional response to questions can also be available. All in all, teachers of prestige are less noticeable because students benefit more from online learning tools.



Source: National Training Laboratories, Bethel, Maine, U.S., Collated by Deloitte

[Deloitte Perspective]

The traditional education has been overturned by its online competitor with regard to the reconsideration of the value of prestigious teachers. Those who have been shining in brick-and-mortar classrooms don’t necessarily acquire the same title on the Internet. It takes much more to keep students lingering behind computer monitors, involving competencies in speech, presentation, program conceptualization, and marketing. Online practices break the walls of a closed campus and add to the transparency of teaching processes, putting the assessment of a certain teacher’s performance in the hands of students, parents, peers, and the society as a whole. Even for K12 extracurricular courses, taught in classrooms, teachers are open to online reviews. The Internet exposes them on a much bigger platform to competition from various domestic and foreign elite schools. It’s no exaggeration to say that a prestigious college teacher is always one step away from being replaced by a grass roots one.

4.3 Can online education be free?

[Background]

In February, 2014, YY Inc. (NASDAQ: YY) announced in Beijing the establishment of 100 Online Education, a one billion yuan investment phased over two years, as an independently operating brand, offering live interactive online learning for free. The service gives away formerly expensive programs like TOEFL and IELTS charged at an average of RMB 3,000+ for an intensive training program. Since the appointment began on its website, more than 16,000 applicants have signed up. So, can online education be free for real?

[Yes]

Offering free services builds up the user base. When it grows to a certain size, users can be used to create commercial value generating network traffic, and some of them turned into service payers. The 100 Online Education can

also offer premium services, which will generate considerable revenues by a paying portion as small as 2-5 percent. The service caters to the popular philosophy of “traffic for value” on the Internet. The free-of-charge policy is a feasible strategy, a move that only retains clients and avoids the marketing gimmick label when high quality materials and tools are available. In response to its shortage of teaching talent, 100 Online Education plans to give most of its revenues, or even 100 percent, to its teaching staff who only gain 30 percent from traditional educational institutions – the rest are used to cover offline costs and kept for stiff competition. By contrast, 100 Online Education seems like a better deal. Free education can happen on the Internet. TOEFL and IELTS charged at an average of RMB 3,000+ for an intensive training program. Since the appointment began on its website, more than 16,000 applicants have signed up. So, can online education be free for real?

Table 9

How Online Education Profits		
Profit Sources		Examples
Content Creation	Charging courses and teaching materials	New Oriental; Tomorrow Advancing Life (Xueersi Online School); XSTeach
Premium Services	Providing paid services like test preparation, employment consulting, big data mining, and learning tools	New Oriental; Yuantiku
Platform Commissions	Taking commissions from participating educational institutions and allowing them to offer courses and teaching materials on such platforms	Taobao Xue; YY Edu
Marketing	Charging website advertisers	Extensive use
Software	Applications designed for mobile ends	Mostly for preschool education

Source: 2013 Analysis of Profit Sources for Online Education in China, Collated by Deloitte

[No]

Education in nature can't be operated on a free-of-charge basis. What 100 Online Education is doing is simply offering free services as part of its early marketing campaign. They will put a price on the follow-up courses. So it's not free in a real sense. It's certain, however, that online services will significantly cut tuition fees, and the gross profits for offline training facilities won't be as high as they are now.

In light of its profit patterns, there're many inherent impediments. YY after all specializes in Internet-based game and music services, and its existing users don't find its educational products relevant. So YY is lacking in users in that department. Secondly, learners are oriented towards results and efficiencies, willing to pay for reliable, high quality courses instead of free ones from a vast selection of online English courses. Platforms like 100 Online Education promise more career potential for teachers. Joining 100 Online Education is equal to beginning a new career to build personal image. As mentioned before, the teaching results can be quite different on or off the Internet. It's a great challenge to teachers themselves. It remains to be seen whether 100 Online Education can put together a team of good teachers in a short period of time for as many students as possible. Thus, the free strategy is a nonstarter.

[Deloitte Perspective]

100 Online Education has provoked huge controversy. Arguments over whether education can be free have inspired people to reconsider the nature of online education. In the Internet era, impossible is nothing. By introducing the TOEFL and IELTS programs, 100 Online Education enters the certificate-based English training market, and thus is expected to attract a large audience. By giving teachers more of its revenues, the platform has great appeal for the teaching talent. As Yu Minhong, New Oriental Board Chairman & CEO, put it, "In the future, the only contribution offline education can make is to maintain a high-end, finely targeted market. Educational services are like any other products. Why bother to visit a shop if you can get a better deal on Taobao [a Chinese website for online shopping similar to eBay], plus free delivery? Field trips are about high value-added products." It can be seen that the 100 Online Education model is sensible and conducive to business growth, even though such an ideal model is challenged at multiple levels for the time being.



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